

REPORT OF THE AUDITOR-GENERAL TO THE MUNICIPAL COUNCIL AND THE KWAZULU-NATAL PROVINCIAL LEGISLATURE ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF ULUNDI MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2007

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Ulundi Municipality, which comprise the statement of financial position as at 30 June 2007, statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes as set out on pages 5 to 30.

Responsibility of the accounting officer for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting determined by the National Treasury, as set out in accounting policy note 1 in the financial statements, and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA). This responsibility includes:
 - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
 - selecting and applying appropriate accounting policies
 - making accounting estimates that are reasonable in the circumstances.

Responsibility of the Auditor-General

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on my audit in accordance with the International Standards on Auditing. Because of the matters discussed in the Basis for disclaimer of opinion paragraphs, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis of accounting

4. The municipality's policy is to prepare financial statements on the basis of accounting determined by the National Treasury as set out in accounting policy note 1 to the financial statements.

Basis for disclaimer

5. The failure to provide sufficient and appropriate audit evidence, satisfactory information and explanations, and working papers for numerous transactions and balances in the financial statements limited the scope of the audit. In this regard, the municipality's records did not permit the application of alternative auditing procedures to substantiate the applicable financial statement assertions in respect of these transactions and balances.

5.1 Property, plant and equipment

The completeness and valuation of property, plant and equipment totalling R16 815 353 as disclosed in note 10 to the financial statements could not be verified due to:

- 5.1.1 Supporting documentation for fixed assets acquired during the year under review totalling R543 130 could not be produced on request. Furthermore, the fixed asset register was not updated for these acquisitions.
- 5.1.2 An annual physical verification of assets was not performed by the municipality.
- 5.1.3 Depreciation for the financial year under review was not raised.
- 5.1.4 The calculation of the accumulated depreciation of R136 683 760 could not be substantiated, as it was not adequately supported.
- 5.1.5 The municipality did not include accounting policies for leased assets nor distinguish between owned and leased assets in the financial statements; notwithstanding the fact that certain lease agreements were in place during the year under review.
- 5.1.6 Supporting documentation for transactions and balances for lease agreements could not be provided upon request.

5.2 Investments

5.2.1 Call accounts were not recognised as held-to-maturity financial assets

Short-term call account bank balances totalling R19 554 821, as disclosed in note 17 to the financial statements had not been accounted for as held-to-maturity financial assets in accordance with the measurement provisions of paragraph 43 and 46(b) of International Accounting Standard (IAS) 39.

5.2.2 Summary of investments not reflected in financial statements

Investments as disclosed in note 17 to the financial statements were not summarised to give effect to the disclosure requirements as set out in section 125(2)(b) of the MFMA.

5.3 Bank reconciliations

Monthly bank reconciliations were not performed during the year under review. Consequently, it was not possible to determine whether the cashbook reconciled to the bank statements on a monthly basis.

5.4 Receivables and payables not measured at fair value

Current assets of R23 824 608 and current liabilities of R7 032 601 have not been recognised or measured (discounted) in terms of International Accounting Standard (IAS) 39 (AC133) (Financial Instruments: Recognition and Measurement) nor disclosed in terms of IFRS 7 (Financial Instruments: Disclosures). Consequently, the financial effects of interest, receivables, and revenue misstatements could not be reliably ascertained. In this regard, the municipality will have to determine the applicable discounting period as well as an appropriate discount rate in accordance with its risk profile, to ensure that receivables and payables are fairly valued.

5.5 Receivables

The completeness, existence and valuation of debtors could not be verified as follows:

- 5.5.1 Detailed listings for consumer debtors totalling R56 096 480 were not provided on request.
- 5.5.2 Debtor suspense accounts totalling R1 057 582 were not adequately supported and cleared timeously.
- 5.5.3 Vendors, who sell prepaid electricity on behalf of the municipality, were not depositing the amounts due to the municipality from prepaid electricity sales timeously as stipulated in the Agency Agreements. Moreover, the amounts due to and not received by the municipality from the vendors at 30 June 2007 were not recognised as debtors.
- 5.5.4 The "Computer day-end routine" account totalling R3 104 818, which summaries differences between the debtor subsidiary ledger and the debtors control account in the main ledger, was not reconciled and cleared timeously.

5.6 Provision for doubtful debts

Specific policies and/or adequate supporting explanations for the calculation of the provision for doubtful debts of R57 005 155 as disclosed in note 15 to the financial statements could not be provided. Consequently, to determine the reasonability and adequacy of the doubtful debt provision, a comparison was made of all debtors outstanding for more than 90 days, (per the summarised age-analysis), to the doubtful debt provision, resulting in an estimated underprovision of R14 625 772.

5.7 Payables

The existence, completeness and valuation of creditors could not be verified as:

- 5.7.1 Creditor suspense accounts totalling R6 513 151 were not adequately supported and cleared timeously.
- 5.7.2 Trade and other creditors totalling R7 032 601, as disclosed in note 6 to the financial statements, could not be verified, as supporting documentation, listings and reconciliations could not be produced on request.
- 5.7.3 Reconciliations of trade creditor accounts with supplier statements were not performed monthly, and prior to payments being made to suppliers.

5.8 Inventory

The existence, completeness and valuation of inventory could not be verified as:

- 5.8.1 The theoretical inventory value disclosed in the financial statements did not agree to the actual inventory on hand as per the year-end inventory stock count, by an amount of R573 512, which has not been accounted for and corrected. Moreover, an inspection of the general ledger listing reflected an inventory balance of R1 288 049.

- 5.8.2 The detailed stock listing, fuel registers and period-end variance analysis could not be produced on request.
- 5.8.3 Goods received vouchers (GRV's) could not be matched with the delivery notes and invoices due to insufficient details captured thereon.
- 5.8.4 No periodic reconciliation was performed of the stock records to the stock count listings and purchases in the cashbook.

5.9 Revenue

- 5.9.1 The occurrence, completeness and accuracy of revenue totalling R39 124 975 could not be verified, as a result of the following:
 - a) A detailed service transaction listing as well as a listing of new service connections could not be provided on request.
 - b) Service charges printout (that is, revenue transactions listing for all services provided by the municipality, for example, penalties and collection charges), was not furnished on request.
 - c) Monthly reports, which calculate and monitor any distribution losses between the actual units purchased versus units sold for electricity was not produced on request.
 - d) An updated supplementary valuation roll could not be provided on request.
 - e) Monthly valuation roll reconciliations were not prepared and reviewed by a senior municipal official.
 - f) A property register, which was supplied, was not properly maintained and did not comply with the requirements set out in sections 17 and 23 of the Municipal Property Rates Act, 2004 (Act No. 6 of 2004).
- 5.9.2 The occurrence, completeness and accuracy of grant income recorded could not be adequately verified due to the following:
 - a) A register of grants was not maintained.
 - b) The source of grants could not be easily verified due to insufficient details on the bank statements.
 - c) Reconciliations of grants to the general ledger were not performed.
 - d) No evidence of communication/correspondence with the transferor of the grants was maintained.

5.10 Expenditure

- 5.10.1 The completeness, accuracy and occurrence of expenditure totalling R325 201 could not be verified, since ten payment vouchers could not be produced on request.
- 5.10.2 Reconciliations were not performed between the monthly payroll reports and general ledger account to ensure accuracy of recording, classification and completeness of salary costs.

5.11 Journal adjustments

The existence, authorisation, accuracy and completeness of journal adjustments could not be verified as:

5.11.1 No documented and approved policy as well a procedure manual for journal adjustments could be produced on request.

5.11.2 Reconciliations between the general journal file and the general ledger were not performed.

5.11.3 A large number of journal entries were passed after year-end.

5.11.4 Journal adjustments totalling R3 669 207 were not supported by documentary evidence.

5.11.5 Journal adjustments totalling R5 832 241 were not signed as proof of approval by a senior official of the municipality.

5.11.6 Recorded entries selected from the general ledger totalling R11 211 165 were not supported with original journals and supporting documentation.

5.12 Related parties

The municipality did not disclose related parties and transactions with these parties for key management personnel in the financial statements as required by IAS 24 (AC126) (Related party disclosures). Moreover, policies and procedures were not developed by management to ensure that related parties and transactions were identified.

5.13 Capital commitments

The financial statements did not disclose any capital commitments for the year under review. Moreover, management did not maintain any records and contract registers in this regard. Consequently, it was not possible to determine whether the financial statements were fairly presented for capital commitments.

5.14 Comparative amounts

Notwithstanding, the fact that these matters were raised in the previous audit report, it was noted that the financial statements were submitted for audit with re-stated comparative amounts and opening balances again.

5.15 Discrepancies between the general ledger and financial statements

Various journal adjustments were made to the general ledger after the submission of the financial statements. Consequently, the general ledger amounts do not agree to the financial statement amounts for the affected adjustments/accounts.

5.16 Prior year's financial statements qualified - not resolved

The qualification matters raised in the prior period's audit report were not rectified in the current period.

Disclaimer of opinion

6. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have been unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements of Ulundi Municipality. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matter

7. Basis of accounting

As set out in note 1 to the financial statements, National Treasury approved a deviation from the basis of accounting applicable to the municipality in terms of *Government Gazette 552 of 2007 issued in Government Gazette 30013 of 29 June 2007*.

OTHER MATTERS

I draw attention to the following matters that are ancillary to my responsibilities in the audit of the financial statements:

8. Non compliance with applicable legislation

8.1 Municipal Financial Management Act

The following instances of non-compliance with the MFMA were noted:

- 8.1.1 The financial statements were not submitted to the Auditor-General within two months after the financial year end, as required by section 126(1)(a).
- 8.1.2 The quarterly management expenditure reports as required by section 71(1) were not submitted to the Treasury timeously.
- 8.1.3 There was no formally approved fraud prevention plan, a risk management strategy and contingency plan in place as envisaged in section 62(1).
- 8.1.4 The recommendations made by the Auditor-General in the prior years' audit reports have not been implemented, in contravention of section 131(1).
- 8.1.5 Regular back-up of client data was not performed and stored in an offsite location.

9. Matters of governance

- 9.1 A fully functional audit committee was not in operation for the year under review. Consequently, oversight mechanisms were not in place to enhance the integrity of financial reporting and to perform an assessment of the effectiveness of the internal audit function.
- 9.2 Internal control deficiencies were not identified by the internal audit function and communicated in a timely manner to management and to those responsible for taking corrective action.
- 9.3 Management did not perform risk assessments nor was a policy developed to manage risks impacting on the municipality. Consequently, management was unable to identify

potential threats and opportunities to fully promote the overall well-being of the municipality.

10. Internal control

Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes of the matters indicated, as they relate to the five components of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
Basis for disclaimer of opinion					
Property, plant and equipment	✓	✓	✓		✓
Investment and bank		✓	✓		✓
Receivables and payables		✓	✓		✓
Inventory		✓	✓		✓
Revenue		✓	✓		✓
Expenditure		✓	✓		✓
Journal adjustments	✓		✓		✓
Disclosure	✓	✓	✓		✓
Emphasis of matter					
Applicable basis of accounting – departures and deviations	✓				
Other matters					
Non-compliance with applicable laws and regulations	✓			✓	✓
Matters of governance	✓	✓			✓

11. Special investigations in progress

A criminal case, regarding the non-payment of R1 234 742 by a vendor, who sold electricity tokens on behalf of the municipality, was opened with the South African Police Services, for breach of contractual obligations.

OTHER REPORTING RESPONSIBILITIES

Reporting on performance information

12. I was engaged to review the performance information.

Responsibility of the accounting officer for the performance information

13. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

Responsibility of the Auditor-General

14. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 646 of 2007*, issued in *Government Gazette No. 29919 of 25 May 2007* and section 45 of the MSA.

15. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

16. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Findings (performance information)

17. **Non-compliance with regulatory requirements**

The entity has not reported performance against predetermined objectives, as required by section 40 of the MSA.

APPRECIATION

18. The assistance rendered by the staff of the Ulundi Municipality during the audit is sincerely appreciated.

) Pietermaritzburg

30 April 2008



A U D I T O R - G E N E R A L